

Declassified in Part -   
Sanitized Copy Approved for Release 2011/10/31 :   
CIA-RDP85T00875R00160003

Declassified in Part -   
Sanitized Copy Approved for Release 2011/10/31 :   
CIA-RDP85T00875R00160003

Doc/Ser

CIA/OER/Im 70-182

~~Secret~~

25X1



DIRECTORATE OF  
INTELLIGENCE

# Intelligence Memorandum

*Jordan: Financial Impact Of Internal And External Strife*

**DOCUMENT SERVICES BRANCH  
FILE COPY  
DO NOT DESTROY**

~~Secret~~

ER IM 70-182  
December 1970

Copy No. 52

## WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1  
Excluded from automatic  
downgrading and  
declassification

SECRET

25X1

CENTRAL INTELLIGENCE AGENCY  
Directorate of Intelligence  
December 1970

INTELLIGENCE MEMORANDUM

Jordan: Financial Impact Of Internal  
And External Strife

Introduction

Jordan, believing itself threatened by Iraq and Syria as well as by the Fedayeen, is planning substantial new expenditures. It is seeking US aid to replace the equipment losses incurred in the September fighting and to expand, reorganize, and reequip its armed forces at a time when the pressures on the balance of payments are becoming increasingly severe. Arab aid is decreasing. This memorandum traces briefly the financial trends since the June 1967 war, assesses the impact of the troubles with the Fedayeen in 1970, and examines prospects over the next year.

The Problem

1. Long supplied by US grants and, since the 1967 war, by Arab grants, Jordan is facing the prospects of a fundamental balance-of-payments problem. Foreign aid commitments have now declined \$50 million since the record level in 1968, while civilian imports have increased about as much. In addition, the recent conflict with the Fedayeen has raised the requirements for imports of military equipment. As a result of these changes, the balance of payments has slipped sharply from a large surplus to a deficit (including present military commitments) which could reach \$100 million next year. Additional non-grant military imports would raise this figure.

*Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence and the Office of National Estimates.*

SECRET

25X1

## SECRET

2. Jordan still has very large foreign exchange reserves -- about \$250 million, or equal to more than one year's normal imports. Jordan's self-imposed currency cover requirement -- 100% -- freezes most of these foreign exchange reserves, however. Free reserves have been falling rapidly; the money supply has grown two and one-half times since the June 1967 war while foreign exchange reserves have risen about 35%. Free reserves at the end of November were only about \$20 million. Within a month or two the continued decline in free reserves will force Jordan to remove the 100% reserve requirement. Jordanian officials fear that such a step would seriously weaken confidence in its currency. Jordanian business people could react by increasing their imports and moving capital abroad, with the result that foreign exchange reserves would drop faster. Jordan could contain this problem by imposing import and capital controls, which would limit speculative flows.

3. Jordan's foreign exchange problems owe more to the conflict with the Fedayeen than to the 1967 war with Israel, although both were costly to Jordan. Loss of the West Bank and Jerusalem deprived Jordan of its only fast-growing major source of foreign exchange earnings -- the tourist trade -- and forced an increase in expenditures for refugee relief. Since the June 1967 war, Israeli shelling of the Ghor Canal and other areas near the border has caused considerable damage to export crops. These costs, however, were more than offset by grants from the Arab countries, and until 1969, Jordan's foreign exchange position improved.

4. The conflict with the Fedayeen had a less obvious impact until this year. Mainly this impact is reflected in the rapid increase in Jordanian military expenditures. Officially aimed against Israel, these expenditures, which are financed by Arab aid, in reality have been increasingly directed against the Fedayeen. The government in 1969 raised the Army's pay to help bolster its morale and perhaps assure its loyalty (until 1969 the Fedayeen received considerably higher pay in the lower ranks), and since 1968 it has greatly increased imports of military equipment. The Jordanian-Fedayeen conflict has put Arab aid donors in a conflicting position. Libya has cut off its \$25 million in annual aid since the September conflict -- a painful blow to Jordan, especially with expenditures rising.

- 2 -

SECRET

## SECRET

Developments Since the 1967 War

5. Jordan's economy came out of the 1967 war in a semi-paralyzed state. Business confidence was at a very low ebb, normal trade patterns were disrupted, and government attention was concentrated on political matters. Economic development expenditures slowed. Total government expenditures rose substantially, however, reflecting higher defense spending and added expenditures for rehabilitation of business and refugee relief (see Table 1). But because of the loss of territory and the drop in economic activity, domestic revenues, which had been rising steadily prior to the war, fell 17% from the 1966 level. There was consequently in 1967 a massive increase in the budget deficit (see Table 2), which in turn was the principal cause of a 70% rise in the money supply.

6. The expansion in money supply was more than offset by a large increase in foreign economic aid to Jordan,\* from about \$50 million in 1966 to about \$125 million (including about \$110 million in grants) in 1967. The government also received military aid in the form of equipment and special military purchase grants, and most of the needs of refugees were covered by aid from the UN, private organizations, and foreign governments.

7. Nearly all the large increase in foreign aid was added to foreign exchange reserves which rose from \$179 million prior to the June war to \$244 million at the end of that year (see Table 3). In spite of the growth of money supply, imports fell sharply, as did domestic non-agricultural activity. The reason appears to have been the severe shock of defeat and the general concern for physical security. It is remarkable that consumer prices were practically stable.

\* At the Khartoum Conference in September 1967, Saudi Arabia, Kuwait, and Libya agreed to provide \$41 million, \$39 million, and \$25 million a year, respectively, to Jordan until the West Bank was recovered from Israel.

## SECRET

Table 1

Jordan: Government Expenditures  
and Domestic Revenue

	Million US \$					
	<u>1966</u> <u>a/</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
Total expenditures	154	191	226	244	260	300
Defense <u>b/</u>	64	77	108	127	139	176
Other	90	114	118	117	121	124
Domestic revenue	87	72	74	90	87	90

a. Including data for the West Bank.

b. Including public security.

Table 2

Jordan: Impact of the Public Sector  
on the Money Supply

	Million US \$			
	<u>1966</u> <u>a/</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
Public sector cash deficit	20.5	38.4	42.6	24.7
Total increase in money and quasi-money	32.8	51.2	42.6	28.0
Percent of the money supply resulting from public sector cash deficit	62.5	75.0	100.0	88.2

a. Including data for the West Bank.

Table 3

## Jordan's Foreign Exchange and Currency, by Quarter

	1967				1968				1969				1970			
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	4th Qtr (Estimate)	
Foreign exchange reserves (Million US \$)	179	236	245	244	259	250	268	284	271	263	253	263	263	253	250	
Currency in circulation (Million US \$)	88	117	133	144	155	173	177	178	185	194	197	200	204	218	240	
Currency in circulation as percentage of foreign exchange reserves	49	50	54	59	60	69	66	63	68	74	78	76	78	86	96	
Foreign exchange reserves in excess of currency cover requirements (Million US \$)	91	119	112	100	104	77	91	106	86	69	56	63	59	35	10	

SECRET

SECRET



## SECRET

8. The economic recession continued through most of 1968 and, with Arab aid remaining at the high 1967 level, foreign exchange reserves continued to rise -- by \$40 million -- to a peak of \$284 million in December 1968. Meanwhile, a substantial increase occurred in the money supply as domestic government expenditures rose. As in 1967, most of the increment was hoarded.

9. Between the latter part of 1968 and the summer of 1970, when tensions intensified, the economy was generally on the upswing. Imports rose sharply in both 1969 and 1970 to pre-1967 levels for both the East and West Bank (see Table 4). Housing construction boomed. There appears to have been some growth in manufacturing output, and 1969 was a better-than-average year for agriculture. However, 1970 was a poor agricultural year. Prices rose about 7% each year, partly in response to higher demand. With imports higher and exports about stable, the non-military trade deficit increased sharply. The trade deficit was increased further by larger imports of military equipment. At the same time, receipts of foreign aid declined by more than \$25 million in 1969. These declines in grants reflect primarily a cut in non-Khartoum Arab assistance and some UNRWA funds. Foreign exchange reserves fell \$21 million in 1969 and another \$10 million through November 1970. With domestic military expenditures since 1968 rising at an annual rate of about \$15 million and government revenues up only slightly, the money supply continued to grow, reaching \$238 million, or 93% of foreign exchange reserves, by November 1970.

10. The fighting with the Fedayeen (in September 1970) disrupted economic activity and caused an estimated loss of \$45 million in property damages and \$15 million in military equipment. Little of the cost of this conflict, however, has been paid in 1970. For the year as a whole, the balance-of-payments deficit is expected to be more than \$20 million, less than in 1969 because of lower military imports.

#### Impact of the September Fighting

11. The financial impact of the September 1970 fighting with the Fedayeen will be felt in 1971. While Libya ended its aid to Jordan in late 1970,

## SECRET

Table 4  
Balance of Payments a/

	Million US \$					
	<u>1966 <sup>b/</sup></u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
Goods and services	-99	-78	-124	-173	-162	-210
Exports	29	32	40	41	42	40
Imports	-188	-152	-160	-186	-210	-210
Trade balance	-159	-120	-120	-144	-168	-170
Net services	60	42	-4	-29	6	-40 <u>c/</u>
Transfers	95	151	153	125	120	105
Private	7	6	4	3	--	--
Government	88	145	149	122	--	--
Non-monetary	15	6	14	13	20	15
Errors and omissions	14	14	4	2	--	--
Balance	25	93	46	-33	-22	-90

a. Because of rounding, components may not add to the totals shown.

b. Including data for the West Bank.

c. Excluding Armed Forces reorganization package.

SECRET

## SECRET

it met virtually all of the 1970 commitment, and assistance from Libya was only \$6 million below expectations. In 1971, however, Jordan will experience the loss of the full amount of Libya's \$25 million annual contribution. Kuwait also temporarily canceled payments on its \$39 million annual grant. Although Kuwait reportedly will resume payments on December 15, its future intent remains unclear. The Libyan aid suspension alone will reduce Khartoum aid receipts from \$99 million in 1970 to \$80 million in 1971. Failure of Kuwait to honor its agreement would reduce total Khartoum aid to \$41 million annually, the Saudi Arabian contribution.

12. The government will attempt to replace 1970 military equipment losses of some \$15 million, and repair some \$45 million of the war damage to the economy. The Fedayeen fighting also had substantial implied additional costs. Jordan now believes that it must expand, reorganize, and reequip its armed forces substantially, not to fight Israel, but to prepare against hostilities from Syria and Iraq as well as from the Fedayeen. The total costs of Jordan's plans to expand its military are not known. However, a US survey team that visited Jordan in October 1970 has suggested that a package totaling \$187 million would be appropriate. Some \$43 million of this total would be spent in 1971. Also in 1971, Jordan is expected to pay the United States about \$28 million for military goods purchased under a 1970 military sales agreement. In addition to planned military purchases in the United States, Jordan expects to make small purchases of military goods in the United Kingdom in 1971. The total of these purchases is not known, but Aman hopes to spend at least \$11 million for Hawkers Hunter. The government also is expected to increase expenditures to refugees as UNRWA plans to cut back its activities.

13. While Jordan still has substantial foreign exchange reserves, its earnings are not sufficient to finance the additional expenditures resulting from the September fighting. If no additional foreign exchange were spent for imports of military equipment or for rehabilitation, there would be a foreign exchange deficit of at least \$50 million in 1971. This projection conservatively assumes that civilian imports and exports will remain at the 1970 level.

SECRET

SECRET

14. Total foreign exchange reserves plus expected current foreign exchange receipts are still large enough to cover normal civilian needs and military imports of \$100 million a year for almost two years (assuming no further reduction in foreign aid). This would wipe out their foreign exchange reserves. But civilian foreign exchange spending may exceed normal levels if confidence in the dinar wanes. With domestic military expenditures continuing to rise and foreign exchange receipts falling, the amount of currency issue will soon surpass foreign exchange reserves. The Jordanian government considers 100% cover to be a requirement for sustaining confidence in the dinar. It will have no choice but to abandon this requirement, however. The prospective budget deficit for 1971 including foreign aid, on the order of \$110 million, would create an equivalent increase in money supply. There appears to be no chance that foreign budget-support aid of this magnitude will be available. The danger is that Jordanians, projecting the deteriorating situation, will react by increasing spending on imports and by shifting their wealth into foreign currency. In such a situation, foreign exchange reserves could decline rapidly. The Jordanian government would have to impose tight import and exchange controls.

#### Conclusions

15. In spite of the 1967 war with Israel and the loss of the West Bank, Jordan ran a surplus in its balance of payments until 1969. Since then, however, a decline in Arab, mainly Libyan, aid and the military and reconstruction expenditures resulting from the conflict with the Fedayeen have shifted the balance of payments into deficit. For 1971 a deficit of nearly \$100 million is in prospect even if military imports are limited to those already contracted for. About half of this deficit is on civilian account. The deficit could rise well beyond \$100 million if a military reequipment program currently being considered is undertaken without additional foreign financing. The total military bill caused or induced by the September 1970 fighting could approach \$250 million spread over several years.

16. Jordan has enough foreign exchange reserves to cover the prospective \$100 million balance-of-payments deficit for more than two years. The

SECRET

## SECRET

downward trend in reserves, however, coupled with an inflated domestic money supply, could lead to speculative increases in imports and outflows of capital. In such a case the Jordanian government would have to impose import and exchange controls.

17. Although the Jordanian government could hold down civilian imports for a while, it cannot eliminate the prospective balance-of-payments deficit without sharply cutting consumption levels and military expenditures. Exports cover only one-fifth of civilian imports and are unlikely to change much in the next few years. Moreover, so long as the conflict with the Fedayeen continues, there seems to be virtually no chance that increased aid will be forthcoming from Arab countries, and a further decrease in aid from these sources is possible.

SECRET